UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

April 23, 2002

No. 01-2999

Before
Hon. JOEL M. FLAUM, Chief Judge
Hon. WILLIAM J. BAUER, Circuit Judge
Hon. FRANK H. EASTERBROOK, Circuit Judge

CURTIS P. JAHN and
CAPITOL WAREHOUSING CORPORATION,
Plaintiffs-Appellants,

v.

1-800-FLOWERS.COM, INC.,
FRESH INTELLECTUAL PROPERTIES, INC.
and 800-FLOWERS, INC.,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Wisconsin
No. 00-C-446-C
Barbara B. Crabb, *Chief Judge*

ORDER

Defendants-appellees filed a petition for rehearing and rehearing en banc on April 12, 2002. No judge in regular active service has requested a vote on the petition for rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

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for the Western District of Wisconsin
No. 00-C-446-C
Barbara B. Crabb, *Chief Judge*

Argued January 17, 2002 — Decided March 29, 2002

Before Flaum. *Chief Judge*, and Bauer and Easterbrook, *Circuit Judges*. Flaum, *Chief Judge*, concurring.

OPINION

Easterbrook, *Circuit Judge.*

When Madison Truck Brokers subscribed to an incoming-toll-free number in 1976, AT&T assigned it 800 356-9377 at random. Madison Truck Brokers and its successor Capitol Warehousing Corporation used the number in their transportation business until 1982, when they expanded into floral delivery. William Alexander thought that 800-FLOWERS would be the ideal toll-free number for a florist — and someone typing that sequence on a phone's keypad will reach 800 356-9377.

Alexander approached Curtis Jahn, the owner of Capitol Warehousing, with a proposal to test-market floral sales via the 800-FLOWERS number. Jahn and investors recruited by Alexander organized 800-Flowers, Inc., a Wisconsin corporation, to explore the idea and, if events justified, to run a national flowers-by-phone business. Advertisements in New Orleans produced enough calls to encourage further exploration. (The record does not reveal how the venture separated the flower-related calls from truck-related calls, for every call to that number reached Capitol Warehousing's office.) After an infusion of additional capital and resolution of litigation brought by another corporation that claimed trademark rights to "800-FLOWERS" (though the rival lacked the phone number to go with the idea), the business was launched nationwide. At Jahn's request, AT&T transferred the phone number to 800-Flowers (Wisconsin), which became the subscriber and paid all bills. In a move that he may now regret, Jahn took not only an equity stake in the new corporation but also a royalty interest in revenues derived from phone sales. Corporate reorganizations transferred the firm's assets to 800-Flowers (Texas) and later 800-Flowers

(New York), which is among the defendants. Jahn gave up his equity interest but retained his royalty (as restated by an agreement with 800-Flowers (Texas) in 1986, an agreement that contains a Texas choice-of-law clause).

In this suit under the diversity jurisdiction, Jahn accuses 800-Flowers (New York) and its parent corporation 1-800-Flowers.com, Inc. — a corporate name mixing Internet with phone symbols, packet-switched with circuit-switched networks — of failing to pay his full royalty under the 1986 agreement. Defendants responded that payment is illegal under a regulation forbidding the sale of phone numbers — and for good measure they added the inconsistent defense that they have paid Jahn every penny that the agreement requires. The district court concluded that the royalty interest reflects at least in part the value of the 800-FLOWERS number and constitutes a sale proscribed by the 1997 regulation, 47 C.F.R. §52.107(a), even though a stock interest of equivalent economic value would be lawful today. This aspect of the district court's ruling has not been contested on appeal. Next the district court concluded that it is unnecessary to decide whether the 1997 regulation may be applied retroactively. The ongoing *payment* is itself illegal, the judge held, and defendants are excused from further payment because Texas law treats illegality as a form of impossibility that constitutes a defense to non-performance. See *Centex Corp. v. Dalton*, 840 S.W.2d 952 (Tex. 1992).

Given the district court's uncontested finding that Jahn's royalty interest represents the sale of a telephone number, we may assume that the 1982 and 1986 transactions would violate federal law if implemented today. The governing regulation provides:

(a) As used in this section, hoarding is the acquisition by a toll free subscriber from a Responsible Organization of more toll free numbers than the toll free subscriber intends to use for the provision of toll free service. The definition of hoarding also includes number brokering, which is the selling of a toll free number by a private entity for a fee.

(1) Toll free subscribers shall not hoard toll free numbers.

(2) No person or entity shall acquire a toll free number for the purpose of selling the toll free number to another entity or to a person for a fee.

(3) Routing multiple toll free numbers to a single toll free subscriber will create a rebuttable presumption that the toll free subscriber is hoarding or brokering toll free numbers.

(b) The following provision shall be included in the Service Management System tariff and in the local exchange carriers' toll free database access tariffs:

[T]he Federal Communications Commission ("FCC") has concluded that hoarding, defined as the acquisition of more toll free numbers than one intends to use for the provision of toll free service, as well as the sale of a toll free number by a

> private entity for a fee, is contrary to the public interest in the conservation of the scarce toll free number resource and contrary to the FCC's responsibility to promote the orderly use and allocation of toll free numbers.

47 C.F.R. §52.107. Number "hoarding" is proscribed, and subsection (a) defines "hoarding" to include "number brokering", which includes "the selling of a toll free number by a private entity for a fee." As an independent matter it would be difficult to conceive of Capitol Warehousing's corporate mitosis, and the allocation of its toll-free number to one of the offspring, as an episode of either "number hoarding" or "number brokering", whether or not the original corporation's owner was paid for his assistance in the transaction. Capitol Warehousing did not tie up "more toll free numbers than the toll free subscriber intends to use for the provision of toll free service" or "acquire a toll free number *for the purpose of* selling the toll free number" (emphasis added).

The Federal Communications Commission has not made it clear whether *every* transfer for value is a form of "number brokering" even when the transfer does not entail any of the events listed in subsections (a)(1) through (a)(3); the regulation does not contain the word "all" and thus its scope is open to question. To say "A includes B" is not necessarily to say "all B is A." Many firms transfer their phone numbers to their successors (or to ventures spun off into subsidiaries) in order to preserve the good will and custom of the business. The regulation shows that phone numbers cannot be treated like Internet domain addresses, which regularly are sold outright for a fee, but it does not show that all transfers to new ventures are forbidden; it would

not make much sense to have numbers with economic value (such as 800-FLOWERS) perpetually assigned to businesses (such as transportation brokers) that cannot realize this value. Moving assets to higher and better uses is an important goal of any economic system. Drawing a line between these normal and lawful transactions and forbidden "hoarding" or "number brokering" would be a job for the FCC, not for the courts, at least as an initial matter. But we need not send this issue to the Commission under the doctrine of primary jurisdiction, because it is possible to resolve this case on the assumption that all sales are "number brokering".

The district court bypassed the question whether §52.107 proscribes sales that occurred before its adoption. For reasons explained presently, the answer matters — and it is a simple "no." Federal regulations do not, indeed cannot, apply retroactively unless Congress has authorized that step explicitly. See *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988). No statute authorizes the FCC to adopt regulations with retroactive effect, and §52.107 does not purport to affect transactions entered into before 1997. Defendants say that §52.107 just restates prior law, but this position is untenable. Relevant prior law, from the phone companies' tariffs, was that subscribers do not own telephone numbers assigned to them. This meant that the carriers could change numbers without liability to the subscribers. It did not mean that subscribers were forbidden to transact about whatever interests they enjoyed in the use of numbers currently assigned. Consider Internet domain names. These are rented by the year from administrators (one per top domain), yet there is a thriving market in these addresses. This is true of other leaseholds: a lessee does not own the premises but may transfer his possessory interest for whatever price the traffic will bear, unless the lease forbids assignments and subleases. A football team does not own its players but

may trade their contracts. And, as *University of Georgia v. Carroll*, 338 U.S. 586 (1950), holds, broadcast licenses may be sold despite the mantra that the airwaves are a public resource. If broadcast licenses may be sold even though they are not "property" of the licensees, then telephone numbers could be sold until 1997 even though they, too, are not the subscribers' property. Jahn could not have compelled AT&T to transfer the number to 800-Flowers (Wisconsin), but it proved willing to do so, and no rule of federal law in force at the time prevented the firm from compensating Jahn for his assistance in securing this transfer.

Thus we arrive at the question whether deferred payment for a lawful (because pre-1997) sale violates §52.107 — for, if it does, then Texas law gives 800-Flowers (New York) a defense. Yet nothing in §52.107 speaks to payment; the regulation concerns future sales, not compensation for older and thus lawful sales. That's what it means to say that the regulation is not retroactive. All "retroactivity" *could* mean for these parties would be a prohibition against future payments. (Surely defendants do not think that the regulation compels AT&T to restore 800 356-9377 to Capitol Warehousing, the original subscriber!) Changing today's financial consequences of an earlier transaction is the paradigm of retroactivity. See *Landgraf v. USI Film Products*, 511 U.S. 244 (1994). When Congress compelled mine operators to pay black lung benefits to miners who retired before the law's enactment, the Supreme Court treated this as classically retroactive legislation. See *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976). It did not say, as defendants here do, that a law is prospective when it rearranges wealth for the future; a wealth transfer that depends on events preceding the rule's adoption has a retroactive effect. Defendants insist that §52.107 transfers wealth from Jahn to themselves, on account of events that

occurred in 1982 and 1986. That would be an instance of retroactivity; and as §52.107 is *not* retroactive, it also does not affect the royalty. (Nor does any other rule of federal law do so. Defendants err in supposing that there is a rule against perpetual royalties. See *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979).)

A royalty is a risk-sharing agreement. Instead of paying Jahn up front the estimated value of the phone number, the investors who established 800-Flowers (Wisconsin) and its successors divided the risk with Jahn, so that he would be paid only to the extent the new business succeeded. Suppose they had done things otherwise — paying Jahn a lump sum and dividing the risk among investors who financed that payment. Any attempt to force Jahn to disgorge what he received in 1982 or 1986 would be retroactive. Yet this is no different, as an economic matter, from refusing to make ongoing payments. Suppose that Jahn had manufactured his own lump-sum payment by borrowing against the value of the royalty. A bank could have lent Jahn $1 million (say) in 1986, taking the royalty agreement as security for repayment. The effect on such a lender of losing its security because of a 1997 regulation would be visibly retroactive. So too if 800-Flowers (Wisconsin) had paid Jahn $1 million cash, borrowing the money from bondholders who were promised repayment out of the phone number's future value. Defendants could not have used the 1997 regulation as a reason to stop repaying their bondholders. Or consider yet another example: suppose that Texas were to vote to go dry on January 1, 2003, and ban all imports of liquor, as §2 of the twenty-first amendment permits. During December 2002 a vintner delivers 1,000 cases of its best cabernet sauvignon to a merchant in Texas, on credit. January 1 arrives; no new sales could be made; would the buyer be free to ignore the debt for the wine already received? Surely Texas would not

permit such a step, which would differ but little from theft. If the buyer of wine must pay even after new sales have been forbidden, then the buyer of a phone number must pay too.

Defendants have other arguments that the district court did not consider. We leave these to be sorted out on remand.

REVERSED AND REMANDED

CONCUR

Flaum, *Chief Judge,* concurring. I join the panel's opinion and only comment separately to underscore what I understand to be the holding of this case. The circumstances presented in this appeal are unique (a toll-free telephone number was effectively sold, in exchange for the payment of royalties, prior to the time when such transfers became illegal). I do not consider our decision today to authorize the sale, brokering or hoarding of toll-free numbers, as the FCC has clearly spoken on this issue.

A true copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

00-C-446-C

CURTIS P. JAHN and
CAPITOL WAREHOUSING CORPORATION,
Plaintiffs,

v.

1-800-FLOWERS.COM, INC.,
FRESH INTELLECTUAL PROPERTIES, INC.
and 800-FLOWERS, INC.,

Defendants.

OPINION AND ORDER

This is a civil action for declaratory, injunctive and monetary relief in which plaintiffs Curtis Jahn and Capitol Warehousing Corporation contend that defendants 1-800-FLOWERS. COM, Inc., Fresh Intellectual Properties, Inc. and 800-FLOWERS, Inc. breached a contract to pay plaintiffs a perpetual royalty on certain floral sales in return for undertakings by plaintiffs that included assignment of the toll free phone number 1-800-FLOWERS. Plaintiffs also seek a declaration of defendants' obligations under the contract. Jurisdiction is present under 28 U.S.C. §1332. (Plaintiffs are Wisconsin citizens; defendants are citizens of either New York or Delaware; and the dispute involves more than $75,000.)

Presently before the court is defendants' motion for summary judgment. Defendants contend that the contract is unenforceable because regulations prohibit the sale of an 800 number; enforcement of a perpetual royalty is contrary to public policy; 800-FLOWERS, Inc. has fulfilled its obligations under the contract; the lawsuit is barred by the doctrine of laches; and a portion of plaintiffs' claims is barred by the statute of limitations. Defendants contend also that defendants 800-FLOWERS.COM and Fresh Intellectual Properties are not proper parties to this action. I conclude that the royalty clause of the contract is unenforceable because it requires payment for an act prohibited by federal regulation. Defendants' motion for summary judgment will be granted. It is unnecessary to address the other grounds for defendants' motion.

From the findings of fact proposed by the parties, I find that the following are material and not disputed.

UNDISPUTED FACTS

A. Parties

Plaintiff Capitol Warehousing is a warehousing and trucking business based in Windsor, Wisconsin. Plaintiff Curt Jahn founded Capitol Warehousing in 1978 and is Capitol Warehousing's president, chief executive officer and sole shareholder.

Defendants 800-FLOWERS, Inc. and Fresh Intellectual Properties are separately incorporated subsidiaries of defendant 1-800-FLOWERS.com, Inc. Defendant 800-FLOWERS, Inc. is a floral and gift delivery service that is incorporated in New York. Defendant Fresh Intellectual Properties holds the intellectual properties of the other

companies.

B. Assignment of the FLOWERS Number to Jahn

In 1976, AT&T assigned the telephone number 1-800-356-9377 randomly to Madison Truck Brokers, a trucking brokerage company owned and operated by plaintiff Jahn. The telephone keypad letters associated with that number spell out "1-800-FLOWERS." Madison Truck Brokers was not engaged in any floral-related business and Jahn did not request that particular number. After Jahn formed plaintiff Capitol Warehousing, he transferred the FLOWERS number to that company. Capitol Warehousing continued to use the FLOWERS number in the operation of its warehousing and trucking business. Jahn's contract with the telephone company for use of the FLOWERS number was subject to conditions and tariffs imposed on 800 number service. Jahn knew he had no ownership interest or proprietary right in the FLOWERS number when it was assigned to his company.

C. The Creation of 800-FLOWERS

In the early 1980s, William Alexander developed the concept of using the FLOWERS number for a floral-delivery business. Granville Semmes and David Snow approached plaintiffs with the idea of using the FLOWERS number to take floral orders over the phone in approximately 1981. Jahn, Semmes and Snow did a trial experiment in 1982 and then Jahn asked Alexander to join them. Semmes and Snow had formed a corporation in Louisiana called 800-FLOWERS (La.). Jahn formed 800-FLOWERS, Inc. (Wis.) with the intention of issuing stock to investors. (800-FLOWERS, Inc. (Wis.) is not the same corporation as defendant 800-FLOWERS, Inc., a New York corporation.)

In 1982, Semmes, Snow and Jahn began to test market the 800-FLOWERS concept in New Orleans. Before the test market experiment, neither plaintiff had any experience in the floral industry. Semmes and Snow were engaged in the advertising business and handled advertising and marketing for the business in New Orleans. They secured television advertising slots for customers to call 1-800-FLOWERS for delivery of floral gifts. Customer calls placed in New Orleans to the FLOWERS number were received by 800-FLOWERS, Inc. (Wis.) employees at Capitol Warehousing's Wisconsin offices, who sent the orders back to a New Orleans florist for delivery. Jahn's primary duty was to supervise the two to four telephone operators who processed the orders called in to Capitol Warehousing's offices. Jahn's financial contribution to 800-FLOWERS, Inc. (Wis.)'s business operations was minimal. Jahn provided the office, set up files, created forms and contributed to the development of the 800-FLOWERS business but made no monetary outlay for the test marketing. Semmes and Snow paid all expenses for the test marketing project and compensated Jahn for floral-order calls placed to the FLOWERS number, which Jahn continued to use for Capitol Warehousing's business. It was anticipated that if the test market was a success, Jahn, Snow and Semmes would engage in a business transaction for the sale of flowers by telephone.

The test marketing period was short-lived because a Madison, Wisconsin-based florist, Felly's Flowers, brought suit against plaintiffs, Snow and others for trademark infringement in August 1982. Later, 800-FLOWERS, Inc. (Wis.) was added as a defendant. Felly's had registered the trademark "Dial 1-800-FLOWERS" sometime in the 1970s, before the FLOWERS number had been issued. Because 800-FLOWERS, Inc. (Wis.) was unable to pay for the defense of Felly's suit, Alexander brought in new, Texas-based

investors, James Poage and John Davis, to finance the litigation. The federal court dismissed Felly's complaint. Felly's appealed but the litigation settled in the spring of 1984. In exchange for funding the lawsuit, Poage and Davis received an option to purchase a majority interest in the business.

D. The 1982 Initial Agreement and Transfer of the FLOWERS Number

On May 20, 1982, on behalf of Capitol Warehousing, Jahn executed an "Agreement to Release Telephone Number," transferring the FLOWERS number to 800-FLOWERS, Inc. (Wis.) and "releasing any claim to the use of this telephone number now or at any future date." On May 20, 1982, 800-FLOWERS, Inc. (Wis.) agreed to assume all outstanding charges, billed and unbilled, for the FLOWERS number. These documents were filed with AT&T and accepted by AT&T. Bills for use of the telephone number from June 1, 1982 to 1984 were submitted to 800-FLOWERS, Inc. (Wis.). No money or other consideration was paid by 800-FLOWERS, Inc. (Wis.) or anyone else on May 20, 1982 to plaintiffs in return for the assignment of the telephone number. Jahn controlled 800-FLOWERS (Wis.) until late September or early October 1982, when stock was issued.

The agreement among Semmes, Snow, Jahn and Alexander to fund the defense of the Felly's lawsuit included the subsequent operation of a business plan involving telemarketing flowers nationwide. Pursuant to this agreement, Jahn executed a Consent Resolution of Incorporator adopting the Restated Articles of Incorporation on September 27, 1982. The Restated Articles of Incorporation were signed by plaintiffs on September 27, 1982. On that day, plaintiffs

executed a bill of sale acknowledging that they had transferred the FLOWERS number to 800-FLOWERS, Inc. (Wis.). The bill of sale was needed to document the May 1982 assignment of the number for the corporate records. On September 28, 1982, Alexander subscribed to 34,085 shares of Class A common stock in return for $25,000 to be used in connection with the defense of the litigation. On September 28, 1982, pursuant to the agreement of the parties, Semmes and Snow each subscribed to 3,652.5 shares of Class A common stock; no consideration is recognized in the subscription. On September 28, 1982, plaintiffs subscribed to a total of 7,305 shares of Class B common stock. The agreement for subscription provides that the shares shall be distributed promptly upon the corporation's receipt of a bill of sale or such other document of assignment as the attorneys for the corporation might request to evidence the assignment of all right, title or interest to the FLOWERS number.

On October 2, 1982, plaintiffs entered into an agreement with 800-FLOWERS, Inc. (Wis.) providing for the payment of royalties to plaintiffs and providing that 70% of the stock would be issued to Alexander, 7.5% would be issued to Semmes, 7.5% would be issued to Snow and 15% would be issued to plaintiffs. By the terms of the agreement, Jahn gave up control of 800-FLOWERS, Inc. (Wis.), which was the subscriber to the FLOWERS number, and the parties recognized his participation in the business, including the prior assignment and transfer of the telephone number to 800-FLOWERS, Inc.

The October 2, 1982 agreement was intended to "evidence the terms" of "the consideration to be received by Jahn and Capitol for and as a result of their assignment of [the] FLOWERS [number] to the Corporation." Under the agreement, Jahn received a defined, quarterly royalty on 800-

FLOWERS, Inc. (Wis.)'s future income in exchange for the transfer and use of the FLOWERS number. The royalty was not tied to Jahn's employment with 800-FLOWERS or to any stock he might receive in the company. The agreement was prepared pursuant to "developing and marketing a business and system which employs and incorporates [the] FLOWERS [number] for the purpose of soliciting and receiving orders for and affecting the delivery of floral products through a telephone brokerage system or similar device" and recognized that Jahn had previously transferred the number to the corporation and should receive consideration for that transfer. The initial agreement states that Jahn's right to a royalty was perpetual and would be passed on to his heirs. Although 800-FLOWERS, Inc. (Wis.) was allowed to license the use of the FLOWERS number to other entities, any assignee was required to assume the perpetual royalty obligation. Under the agreement, if an assignee defaulted on its royalty obligations the assignee would forfeit its interest in the FLOWERS number and the number would revert to 800-FLOWERS, Inc. (Wis.).

The October 2, 1982 agreement was one part of the agreement among Semmes, Snow, Alexander and Jahn to form a business and share in its profits. Alexander would not have agreed to the royalty agreement had he not received 70% control. By document dated October 3, 1982, Davis and Poage, doing business as DP Joint Venture, agreed to provide funds for the defense of the litigation in return for an option to enter into a joint venture with 800-FLOWERS, Inc. whereby DP Joint Venture would receive 85% of the net profits initially and 70% of the net profits later. Jahn, Alexander, Semmes, Snow, Griffin, Davis and Poage all knew that the companies they formed did not have an ownership interest in the FLOWERS number and that the number could be transferred or assigned from one customer

to another.

In 1984,800-FLOWERS, Inc. (Wis.) was dissolved and its assets were transferred to 800-FLOWERS, Inc. (Texas).

F. The 1986 Amended Agreement

800-FLOWERS, Inc. (Texas) continued to struggle financially after Poage and Davis took over the company and moved it to Texas. In a 1985 letter to Jahn, 800-FLOWERS' new president wrote that "cash is an extremely tight commodity... [and a]s a result we have reduced the organization by 30%. By 1986, the company was in "desperate straits" financially.

In an effort to save the company, a successful florist based in New York, James McCann, proposed that Poage and he acquire a controlling interest in 800-FLOWERS, Inc. (Texas), with McCann managing the company's operations. McCann understood that the broad nature of Jahn's royalty under the initial agreement had been an impediment to previous efforts to sell the company. Among McCann's and Poage's requirements for additional investment in the company was that Jahn's royalty be narrowed and more clearly defined and that McCann's existing businesses be excluded from the royalty.

In order to facilitate McCann's acquisition of the company, Poage was charged with negotiating a new royalty agreement with Jahn. On October 10, 1986, Jahn and his attorney, A. J. Griffin, III, met with Poage in Madison, Wisconsin, at which time Poage presented them with a draft of the amended agreement. Jahn and Griffin read the amended agreement and Jahn signed it in Griffin's presence. The

amended agreement narrowed the sources of revenue to which Jahn's royalty would apply. The amended agreement provides, "This Agreement shall be governed by and interpreted, construed and enforced in accordance with the laws of the State of Texas." The amended agreement states,

> WHEREAS, [plaintiffs] have heretofore transferred and assigned to MADISON VENTURE, a joint venture comprised of 800 Flowers, Inc., a Wisconsin corporation, and DAVIS POAGE VENTURE, INC., a Texas corporation, which subsequently assigned their entire right, title and interest in and to [the FLOWERS number];
>
> WHEREAS, all of the right, tide and interest of said MADISON VENTURE in and to the [FLOWERS] Number was subsequently and eventually acquired by [800-FLOWERS, Inc. (Texas)]; and
>
> WHEREAS, the parties hereto desire to amend and restate in its entirety [the initial agreement].

The amended agreement contains an integration clause disavowing any earlier representations or agreements of the parties.

On June 21, 1996, defendant 1-800-FLOWERS.COM, Inc. (then known as 1-800-FLOWERS, Inc.) assumed all the obligations of 800-FLOWERS, Inc.. (Texas). On July 1, 1996, defendant 800-FLOWERS, Inc. (New York) assumed all the obligations of 800-FLOWERS, Inc. (Texas).

G. Toll Free Numbers

The Federal Communications Commission is not involved in the day-to-day allocation of toll free numbers but instead leaves the mechanics of the actual allocation of numbers to the industry. All toll free numbers are stored in a single computerized database, the System Management System (SMS/800). Spare toll free numbers are assigned to subscribers on a first-come, first-served basis. Toll free service providers must be certified by the database administrator as "responsible organizations."

The telephone industry establishes guidelines and files tariffs for toll free number service in compliance with the Federal Communications Commission's requirements. The tariffs filed with the commission provide specifically that subscribers have no "proprietary interest in any given 800 number." The 800 Industry Tariffs currently on file with the Federal Communications Commission provide that "[a]ll entities (e.g. Resp[onsible] Org[anization]s, subscribers, service providers) are prohibited from selling, brokering, bartering and releasing for a fee (or otherwise) any 800 number" and "[t]oll free numbers are not to be treated as commodities which can be bought or sold, and no individual or entity is granted a proprietary interest in any Toll Free number assigned." AT&T's 1984 tariff §2.1.7 reads, "nothing herein or elsewhere in this tariff shall give any customer, assignee, or transferee any interest or proprietary right in any given AT&T 800 service telephone number." The 1993 Bell Operating Companies' tariff includes the above language and also states, "All entities (e.g. Resp[onsible] Org[anization]s, subscribers, service providers), are prohibited from selling, brokering, bartering, and releasing for a fee (or otherwise) any 800 number."

Telephone numbers used in the operation of a business have a value and that value is recognized in the price of the business when it is transferred either by asset sale or stock sale.

Jahn has received more than $1 million in royalties under the initial and amended agreements.

OPINION

Defendants contend that the amended agreement should not be enforced because (1) plaintiffs had no property interest in the FLOWERS number to sell; (2) payment of a royalty interest for transfer of an 800 number is prohibited by regulation; and (3) enforcement is outweighed by public policy considerations. Plaintiffs contend that the royalty payment was not made in return for bartering, brokering or selling the FLOWERS number but instead was made in return for control of 800-FLOWERS and in recognition of the facts that Jahn had transferred the number to the corporation previously and that the number had value to the business.

A. FCC Rules Against Sale of Toll Free Numbers

The Federal Communications Commission has exclusive jurisdiction over those portions of the North American numbering plan that pertain to the United States. *See* 47 U.S.C. § 251 (e) (Supp. 2001). The law today is clear: "Toll free subscribers shall not hoard toll free numbers." 47 C.F.R. §52.107(a)(1). "The definition of hoarding ... includes number brokering, which is the selling of a toll free number by a private entity for a fee." 47 C.F.R. §52.107(a) (promulgated in April 1997). In its Second Report and Order discussing the 1997 amendments to 47 C.F.R. part 52, the Federal Communications Commission "f[ou]nd that there is

a 'legitimate governmental interest or rational basis' for declaring that toll free numbers are a public resource and that we must ensure that telephone numbers are allocated efficiently and fairly." Second Report and Order, 12 F.C.C.R. 11,162, at ¶ 32. In addition, the commission "f[ou]nd that number brokering, which is the selling of numbers by private entities for a fee, is not in the public interest. Brokering provides motivation for hoarding and therefore results in quicker exhaustion of the current [service access code] and interferes with the orderly allocation of numbering resources." *Id.* at ¶ 38.

Plaintiffs contend that the Federal Communication Commission's statements about number brokering are not relevant to this case because "[t]he FCC's primary concern was with the practice of private entities in accumulating quantities of toll-free numbers and attempting to sell them in ways that would quicken the decline of the number pool." Plts.' Br., dkt. #55, at 6. Be that as it may, the commission did not place any limits on its conclusion that number brokering is not in the public interest. Instead, it stated that toll free subscribers that brokered numbers would be subject to penalties.

The commission has addressed specific instances involving the sale of a toll free number. *See. e.g.*, Federal Communications Commission Letter to Joseph J. Weiss, DA 97-1247, 1997 WL 321717, 13 F.C.C.R. 4122 (Jun. 13, 1997) (finding that "TWC [Communications'] actions in attempting to negotiate the transfer of a toll free number for profit were contrary to the longstanding Commission policy prohibiting the establishment of ownership interests in toll free numbers."). In *Patients Plus, Inc. v. Long Distance Telecommuincations, Service, Inc.*, DA97-1831, 1997 WL 527886, 13 F.C.C.R. 5827 (Aug. 25, 1997), the commission

addressed Patients Plus's complaint that Long Distance Telecommunications Service withheld assignment of the toll free telephone number 1-800-JUSTICE after Patients Plus refused to pay $200,000 for it. The commission noted that the complaint was essentially a contract dispute between two parties whose efforts to undertake a joint venture were unsuccessful and found that Patients Plus had failed to meet its burden of proof. *Id.* at ¶ 19. Specifically, Patients Plus failed to prove that Long Distance Telecommunications had demanded payment for the number. *Id.* at ¶ 34. In response to the defendants' argument that the commission did not have rules proscribing the warehousing of 800 numbers at any time relevant to the complaint, the commission stated, "[a]lthough some of the[] policies [prohibiting the warehousing, hoarding and brokering of toll free numbers] may have only recently been enunciated by the Commission, they reflect long-standing Commission policy that toll-free telephone numbers are a public resource that is not the property of either the carrier or the subscriber. Accordingly, we are not restricted from finding the alleged conduct to be an unreasonable practice in violation of the Commission rules merely because it occurred prior to the recent rulemaking proceeding." *Id.* at ¶ 37. Because the commission had already determined that Patients Plus had failed to prove that the defendants demanded an unreasonable charge for assignment of the number, the case does not test the commission's willingness to apply the anti-brokering rules to contracts entered into before the rules were promulgated. Plaintiffs suggest that the commission's use in *Patients Plus* "of the phrase 'unreasonable charge' shows that the mere fact that consideration is paid for the transfer of a toll free number does not make the transfer contrary to public interest." Plts.' Br., dkt. #55, at 7 n.2. It is more likely the commission used the term "unreasonable" because the claim in that case was brought under 47 U.S.C. §201(b), which prohibits unjust or unreasonable "charges,

practices, classifications, and regulations for and in connection with [wire and radio] communication service." I decline to read into the commission's language an interpretation that a reasonable charge for assignment of the number would have been lawful under the commission's policy against number brokering.

B. Did Plaintiffs Sell the FLOWERS Number?

As the undisputed facts show, plaintiffs' royalty was paid as consideration for plaintiffs' transfer of the FLOWERS number to 800-FLOWERS, Inc. (Wis.), and is therefore a payment for transfer of the number. Although plaintiffs transferred the FLOWERS number to 800-FLOWERS, Inc. (Wis.) in May 1982 and executed a bill of sale stating that the number had been assigned to 800-FLOWERS, Inc. (Wis.) in September 1982, Jahn controlled 800-FLOWERS (Wis.) until stock was issued in October 1982. The initial agreement, entered October 2, 1982, states,

> WHEREAS [plaintiffs] have been the joint owners of all right, title and interest in and to [the FLOWERS number] . . . WHEREAS, the parties have agreed as to the consideration to be received by [plaintiffs] for and as a result of their assignment of [the] FLOWERS [number] to the Corporation and desire to evidence the terms of such agreement herein, [800-FLOWERS, Inc. will pay Jahn a perpetual royalty and issue stock.]

Jahn Dep., dkt. #31, Ex. 6 at J02049. The terms of the agreement indicate that Jahn was paid a royalty at least in part as consideration for his assignment of the FLOWERS number to 800-FLOWERS. The other terms of the agreement for

which the royalty might be consideration are the authorization of two classes of capital stock in 800-FLOWERS, Inc. Even if part of the royalty is for plaintiff Jahn's contribution of time or Jahn's giving up control of the corporation, the undisputed facts show that part of the royalty was paid in return for the assignment of the FLOWERS number. Such an assignment of the phone number in exchange for money is a sale of the number.

Plaintiffs state that before the initial agreement was signed, "Jahn had control of 800-FLOWERS, Inc. and believed he was entitled to compensation different from that received by mere ownership of stock in the corporation." Plts.' Br., dkt. #55, at 4. Because the FLOWERS number was the only real asset of 800-FLOWERS, Inc. (Wis.) that Jahn could lose by giving up control of the corporation, this statement amounts to a concession by Jahn that the royalty clause of the agreement was in exchange for his assignment of the FLOWERS number to the project. Jahn had no experience in the floral industry or any particular skill that would have justified compensating him with more than stock. Plaintiffs argue that "[t]he 1982 creation of a business plan was not a charade. It was a legitimate conscientious effort by four men to create a viable business entity while recognizing the value that each brought to the table." *Id.* at 5. The creation of a business plan does not appear to have been a charade. However, the only thing of value that plaintiff Jahn "brought to the table" was the FLOWERS number. Plaintiffs' argument that "Jahn gave up control in the *corporation* in return for a royalty," *id.* (emphasis in original) is an exercise in semantics; the only thing in the corporation he could relinquish was the FLOWERS number.

This conclusion is not affected by the amended agreement between plaintiffs and 800-FLOWERS, Inc.

(Texas) that has been in effect since October 10, 1986. The initial agreement was a sale of the FLOWERS number for a perpetual royalty; the 1986 amendment changed the description of the royalty but did not change the reason for its payment. Because the royalty is an ongoing payment, owed as long as 800-FLOWERS sells flower products over the FLOWERS number, plaintiffs continue to profit from the assignment of the number. The ongoing payment violates Federal Communications Commission policy and 47 C.F.R. §52.107(a)'s prohibition against selling toll free numbers for a fee.

C. Effect of Regulations on Amended Agreement

Because I have determined that plaintiffs sold a toll free number for a fee, the initial and amended agreements would have been illegal had they been entered into after the 1997 FCC rulings. The legality of assigning a toll free number in exchange for money in 1982 and 1986 is not as clear. However, it is not necessary to reach that question. Neither side focuses on the relevant issue: assuming the amended agreement was valid when it was entered into in 1986, does the 1997 regulation render it unenforceable? Defendants contend that it was illegal to sell the FLOWERS number in the 1980s and alternatively that the 1997 FCC regulation applies retroactively. Plaintiffs also focus on retroactivity and cite a Wisconsin case from 1920 for the proposition that "a contract valid when made cannot be rendered invalid even by legislative action." Plts.' Br., dkt. *#55,* at 9 (quoting *Sheffield-King Milling Co. v. Jacobs*, 170 Wis. 389, 400-401, 175 N.W. 796, 801 (1920)). That statement is not an accurate reflection of the current state of the law.

"[W]here the contract was originally legal, but because of... a change in the law, performance of the acts prescribed in the contract by one of the parties has become illegal, any subsequent performance of such acts is against public policy and the party who has undertaken to perform them is excused from doing so." 8 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts* §19:35 at 365-66 (4th ed. 1998). "Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary." *Restatement (Second) of Contracts* §261 (1981). The non-occurrence of a change in regulation is a basic assumption on which any contract is made. *See Restatement (Second) of Contracts* §264.

The amended agreement provides that it will be interpreted and enforced in accordance with the laws of the state of Texas. The Supreme Court of Texas has recognized the doctrine of impossibility because of illegality. In *Centex Corporation v. Dalton*, 840 S.W.2d 952 (Tex. 1992), Centex contracted to pay Dalton a consulting fee over three years if Centex was successful in acquiring four central Texas thrift organizations. After Centex acquired the thrift organizations, the Federal Home Loan Bank Board approved the acquisition but conditioned the approval on a prohibition against the thrift organizations' direct or indirect payment of finder's fees. *Id.* at 953. The court concluded that because Congress had given the Bank Board power to regulate the acquisition and control of federally-insured thrifts by savings and loan holding companies, the board's prohibition made it illegal for Centex to perform under the letter agreement. *Id.* at 954. The court quoted the *Restatement (Second) of Contracts* §§261 and 264

in holding that Centex was excused from performance by the doctrine of impossibility. *Id.* The court's reasoning applies to this case. After the enactment of 47 C.F.R. §52.107(a)(1) in 1997, it became illegal for defendant 800-FLOWERS, Inc. to continue paying money for the assignment to it of the FLOWERS number, excusing defendant from performance by the doctrine of impossibility.

In *Centex*, the court of appeals had reasoned that because Centex's obligation to pay Dalton arose when the letter agreement was signed and before the Bank Board adopted its prohibition, the prohibition did not apply to the letter agreement and did not bar Centex from paying Dalton his fees. *Id.* at 955. The Supreme Court of Texas disagreed, concluding that because the letter agreement was premised on a condition precedent, Dalton's right to enforce it could not accrue until the Bank Board approved the acquisition. When the Bank Board prohibited the payment of finder's fees as a condition of its approval, it invalidated the letter agreement. Dalton's right to enforce the letter agreement never accrued. *Id.* at 956. Although in this case the condition precedent was not as direct, it is implicit in the performance of any contract that the performance be legal at the time it is performed. *See In re Kasschau*, 11 S.W.3d 305, 312 (Tex. App. 1999) (quoting *Lewis v. Davis*, 199 S.W.2d 146, 148-49 (Tex. 1947)) ("'A contract to do a thing which cannot be performed without violation of the law' violates public policy and is void.").

To plaintiffs' contention that it would be inequitable to relieve defendants of the duty of paying the royalty because defendants have already been assigned the phone number and have gotten the value they wanted from the bargain, there is a straightforward response. "[W]here illegality is raised it is the interest of the public, rather than the equitable standing of

the parties or either of them, that is of importance. The defense of illegality is not allowed because the party raising it is entitled to any consideration, but rather because principles of public policy demand that the defense be raised to promote the public interest." 6 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts* §12:4 at 32-35 (4th ed. 1995). "The rationale behind the rule [voiding contracts the performance of which would be illegal] is not to protect or punish either party to the contract, but to benefit and protect the public." *Kasschau*, 11 S.W.3d at 312.

Defendants are not seeking disgorgement of any royalties they have paid to date and I am not applying the Federal Communications Commission policy retroactively to the amended agreement. Therefore, it is not necessary to address plaintiffs' argument that retroactive application would violate their due process rights under the Fifth Amendment. Plaintiffs contend that because the Federal Communications Commission has exclusive jurisdiction in this area and is the expert in interpreting the scope of its policy and in penalizing violations, the commission and not this court should evaluate defendants' claim that the amended agreement is unenforceable. The policy against selling toll free numbers is codified in 47 C.F.R. §52.107; this court has authority to decline to enforce a contract that violates federal regulations. I will not order any additional penalty for the violation, making it unnecessary to address the limits of this court's authority. The conclusion that the royalty provision of the amended agreement is unenforceable dictates the entry of summary judgment for all defendants.

ORDER

IT IS ORDERED that the motion for summary judgment brought by defendants 1-800-FLOWERS.COM,

Inc., Fresh Intellectual Properties, Inc. and 800-FLOWERS, Inc. is GRANTED. The clerk of court is directed to enter judgment for defendants and to close this case.

Entered this 23rd day of July, 2001.

BY THE COURT:

/s/_____
BARBARA B. CRABB
District Judge